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November 15, 2004

Mr. Keith Rake
Deputy Assistant Commissioner
Bureau of the Public Debt
Department of the Treasury
P.O. Box 396
Parkersburg, WV 26101-0396

Re: Notice of Proposed Rulemaking to Revise Regulations as to State and Local Government Series Securities - Docket No. BPD-02-04

Dear Sir:

Enclosed are comments submitted on behalf of the National Council of Health Facilities Finance Authorities (NCHFFA) and the National Association of Higher Educational Facilities Authorities (NAHEFA) addressing the Notice of Proposed Rulemaking published in the Federal Register on September 30, 2004, to revise the regulations governing State and Local Government Series (SLGS) securities found at 31 CFR Part 344. We appreciate your consideration of the enclosed comments and would be pleased to make ourselves available to discuss these comments or any other aspect of the proposed regulations.

Ver y truly yours,

MAS/CAS

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Enclosure

WDC 357212v1

NATIONAL COUNCIL OF HEALTH FACILITIES FINANCE AUTHORITIES
NATIONAL ASSOCIATION OF HIGHER EDUCATIONAL FACILITIES AUTHORITIES
COMMENTS ON PROPOSED REGULATIONS
REGARDING STATE AND LOCAL GOVERNMENT SERIES SECURITIES
DOCKET NO. BPD-02-04

INTRODUCTION

The following are comments of the National Council of Health Facilities Finance Authorities ("NCHFFA") and the National Association of Higher Educational Facilities Authorities ("NAHEFA") as to proposed regulations regarding State and Local Government Series securities.

NCHFFA represents interests of governmental issuing authorities which provide a tax-exempt capital financing source for not-for-profit hospitals and healthcare facilities.

NAHEFA represents its member higher education tax-exempt bond authorities.

Together, the Associations represent over 30 states.

BACKGROUND

State and local issuers of tax-exempt debt obligations are subject to federal arbitrage restrictions imposed under Section 148 of the Internal Revenue Code of 1986, as amended, (the "Code") with respect to the yield which may be earned from investment of the proceeds of such debt. In order to facilitate compliance with those yield restrictions, the Bureau of the Public Debt offers special non-marketable State and Local Government Series securities ("SLGS") which are only available for purchase by issuers of tax-exempt debt.

In 1996, the Department of the Treasury ("Treasury") revised the then-existing regulations in order to "make the SLGS securities program more attractive and flexible for State and local government issuers of debt obligations that are subject to the arbitrage and rebate rules of the Internal Revenue Code." 61 FR 55690. NCHFFA and NAHEFA believe that the 1996 regulations, by eliminating unnecessary restrictions and causing the SLGS program to be more user-friendly, have succeeded admirably in making SLGS the reinvestment securities of choice in many tax-exempt bond transactions.

NCHFFA and NAHEFA recognize and support Treasury's efforts to make administration of the SLGS program more efficient and to assure that the program not hinder the cash balance forecasting which is essential to minimizing overall Treasury borrowing costs. However, for the reasons stated below, NCHFFA and NAHEFA strongly urge that no changes be made which create disincentives to use of the SLGS program as a vehicle for compliance with federal tax law, a goal which is of crucial importance both to State and local governments and to the Treasury.

COMMENTS

Mandatory use of SLGSafe.

NCHFFA and NAHEFA support mandatory use of the SLGSafe electronic subscription procedure, subject to a "good cause" exception. We believe that increased use of SLGSafe will eliminate most of the administrative burden and cash forecasting concerns which appear to have prompted the proposed amendments to the regulations. NCHFFA and NAHEFA would recommend that the regulations still include the mailing address and fax number to facilitate alternative compliance in those rare instances when it is appropriate, e.g., small and infrequent issuers or times when Internet access is temporarily unavailable.

Change in hours.

While the shortened hours for subscriptions and redemption requests is not a problem for most issuers, NCHFFA and NAHEFA members on the West Coast and in Hawaii have expressed concern about this change.

Certification.

NCHFFA and NAHEFA support the requirement that subscribers identify an actual planned bond issue when subscribing for SLGS. There is no justification for imposing any burden on Treasury as to merely hypothetical or speculative transactions. However, formal authorization of bond issuance may occur under state law only at a late stage in the planning process. A requirement that the subscriber provide a description of the proposed bond issue and state the issuer's reasonable expectation that the bonds will be issued should be sufficient protection, particularly in light of the discretionary rights to punish abusive actions reserved to Treasury in §344.2(m) of the proposed regulations.

Pre-closing changes.

The proposed regulations would eliminate the ability under current regulations to extend the issue date of Time Deposit SLGS by up to seven days. The proposed regulations would also change the current rule which allows a change in the principal amount of Time Deposit SLGS from that initially subscribed for by an amount equal to the greater of $10 million or 10 percent, substituting an absolute 10 percent limitation. NCHFFA and NAHEFA submit that factors beyond the control of the issuer frequently influence both the timing and sizing of bond issues. Acts of God, such as the recent hurricanes in the Southeast, can cause delays in scheduled bond closings. Market conditions may produce the need for last-minute changes in the size of a refunding issue. The proposed regulations remove desirable flexibility provided under current regulations. Their effect goes beyond elimination of the ability to use SLGS for hedging purposes. If necessary, Treasury could require issuers making changes to the issue date or size of a subscription to state the reasons therefor, relying on the rights reserved in §344.2(m) to punish inappropriate exploitation of these provisions.

Elimination of negative arbitrage.

The proposed regulations attempt to eliminate the ability to minimize negative arbitrage by taking advantage of more favorable interest rates through cancellation and resubscription prior to bond closing. Similarly, the proposed regulations attempt to eliminate the ability to minimize negative arbitrage by restructuring existing SLGS escrows by redemption and resubscription or by redemption and purchase of open market securities. These changes appear to result from several policy determinations which deserve to be reconsidered. First, Treasury suggests that the flexibility provided by these practices constitutes a "cost-free option" which is "inconsistent with the purpose of the program." NCHFFA and NAHEFA note that the use of a defined "SLGS rate" under §344.1 which is 5 basis points below the current Treasury borrowing rate means that an issuer purchasing SLGS securities does bear a cost not incurred by investors in open market securities, whether or not that cost is related to the value of any implicit option.

More importantly, even if the current regulations are considered to provide an implicit option to purchasers of SLGS securities, NCHFFA and NAHEFA submit that this flexibility is a meaningful incentive for investment in such securities and that as a matter of federal policy that is a good result not a bad one. The 1996 amendments to the regulations governing issuance of SLGS corresponded in time with a major audit program undertaken by the Internal Revenue Service to identify and challenge so-called "yield burning" transactions, in which issuers were allegedly sold open market securities at prices in excess of fair market value. Because of the forward delivery and contingent nature of such transactions, pricing was difficult. See, for example, the discussion in Revenue Procedure 96-41, 1996-2 C.B. 301, providing for a voluntary closing agreement procedure for such transactions. Issuers of tax-exempt debt such as the members of NCHFFA and NAHEFA were reluctant participants in such transactions and the controversies which followed. The bidding procedures which current regulations provide for avoiding such problems continue to result in additional effort being expended to assure compliance as well as concerns about costs incurred for bidding agents. See Treasury Regulations, §1.148-5(d) and (e). These questions continue to be a major concern of the Internal Revenue Service. In that context, the advantage provided by SLGS securities in minimizing negative arbitrage increases the likelihood that issuers will purchase SLGS and thereby furthers the goal of effortless compliance with federal tax law. Satisfaction of that goal should be far more important to Treasury than assuring that the SLGS program does not provide a cost-free option to issuers.

Finally, Treasury appears to find a policy justification for limiting the ability of issuers to reduce negative arbitrage. Congress long ago addressed allowable yields on the reinvestment of bond proceeds and determined that positive arbitrage should be limited or eliminated. See Section 601(a) of the Tax Reform Act of 1969, 83 Stat. 656. Thirty-five years' worth of increasingly complex regulations and periodic statutory amendments have sought to prevent positive returns on reinvestment from providing an inappropriate incentive to issuance of tax-exempt debt. However, those rules have never attempted to force issuers to incur negative arbitrage where it could be avoided. It would be inappropriate for the Bureau of the Public Debt to do so here.

cc: The Honorable Greg F. Jenner
Assistant Secretary for Tax Policy (nominated)

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